SENATE TAXATION
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MBPC Montana Budget & Policy Center

Policy Brief
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Senate Bill 513: Targeted Property Tax Relief

The Montana Department of Revenue is completing the most recent reappraisal of property values in the state. Based on the most current estimates provided by the Department, the appraisals are likely to result in a statewide average increase of approximately 55% in residential home values and 34% in commercial property. Agricultural land is expected to increase in value by an average of 29% and forestland by an average of 52% statewide. The Governor and leadership of both parties represented in the legislature have expressed a commitment to keeping property tax revenue neutral as a result of the reappraisals[1] and to mitigate the effects of increased property values on taxpayers. Efforts should be taken to ensure that any proposed property tax mitigation is targeted effectively towards those individuals and families least able to pay increased property taxes, namely those who pay an unduly high share of their income in property taxes.

Homeowners' Share of Property Taxes Has Increased Over Time

State and local property taxes collected in Montana make up approximately 13% of our total state and local revenue.2 This policy brief focuses primarily on "Class 4 Residential" property. Class 4 Residential property made up an estimated 49% of all property taxes paid in 2008 (Chart 1). Montana homeowners have seen an increase in the share of property taxes they pay compared to other classes of property, from 38% of all property taxes in 1994 to 49% in 2008 (Chart 2).

Key Points

- Montana homeowners have seen an increase in the share of property taxes they pay compared to other classes of property, from 38% of all property taxes in 1994 to 49% in 2008.
- Montana's property tax system is regressive, meaning that lower-income households pay a higher share of their income in property taxes than higher-income households.
- Traditional mitigation fails to adequately target those most in need of mitigation, namely homeowners for whom property taxes are unduly high in relation to their income.
- Non-residential property owners already have an ability-to-pay consideration incorporated into the method of valuing their classes of property.
- A circuit breaker, like that designed in SB 513, is an efficient and effective mechanism for targeting property tax mitigation towards those homeowners and renters most unable to keep up with rising property taxes.

[1] For a critique of property tax revenue caps see, Karen Lyons and Iris J. Lav, "The Problems with Property Tax Revenue Caps," Center on Budget and Policy Priorities, June 2007 at http://www.cbpp.org/6-21-07sfp.pdf.
[2] State & Local Government Finance Data Query System. http://www.taxpolicycenter.org/slf-dqs/pages.cfm. The Urban Institute-Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (2006). Date of Access: (17-Jan-09 07:09 PM)

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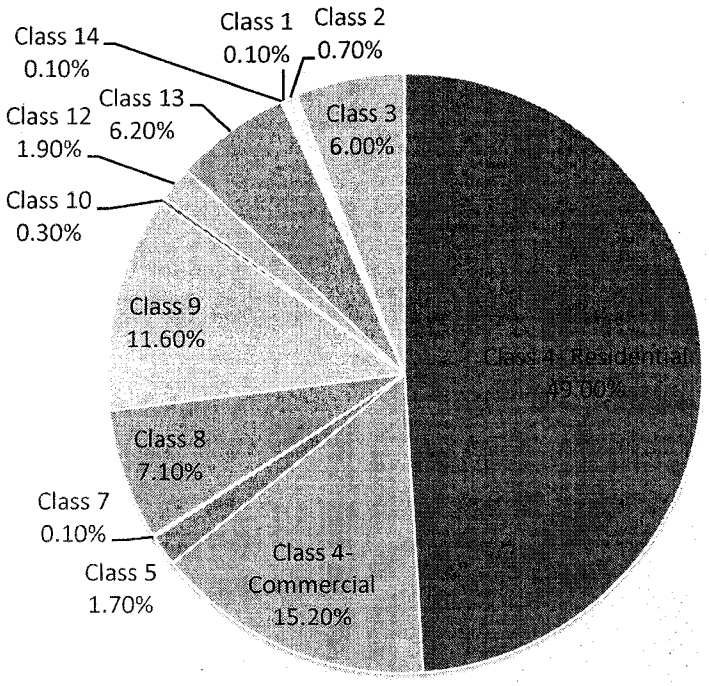
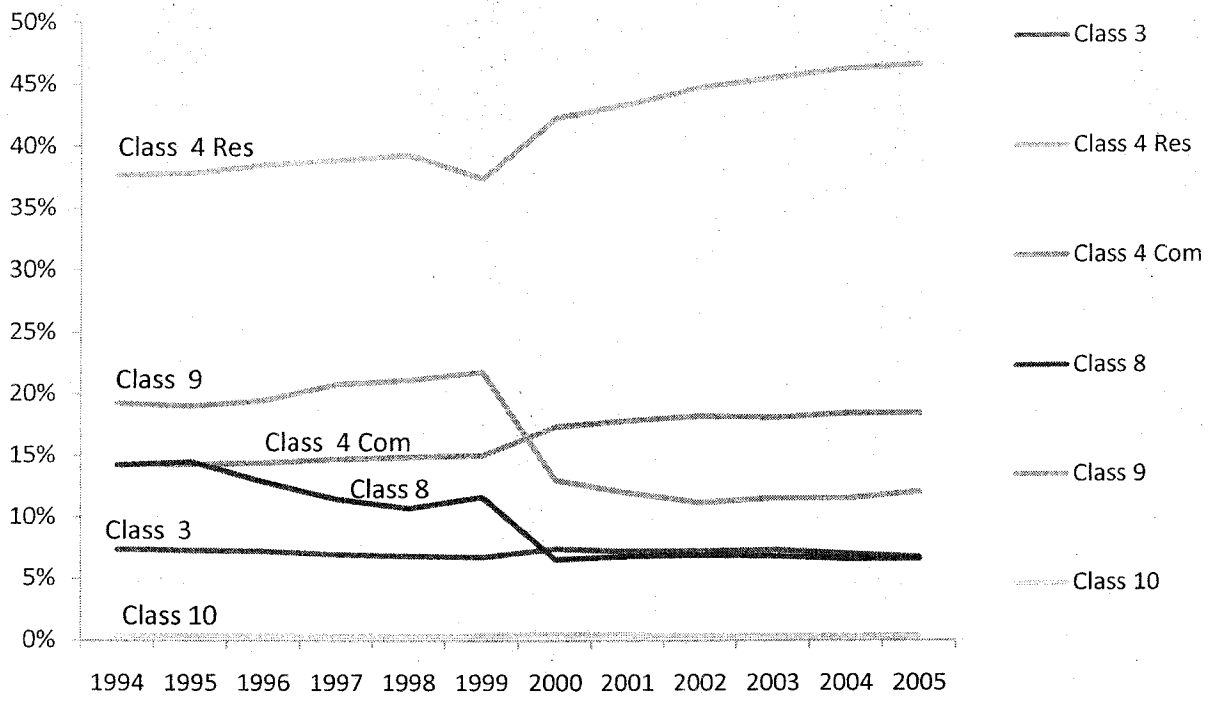
Chart 1: Share of Total Property Taxes by Property Classes, Estimated 2008



Source: Department of Revenue

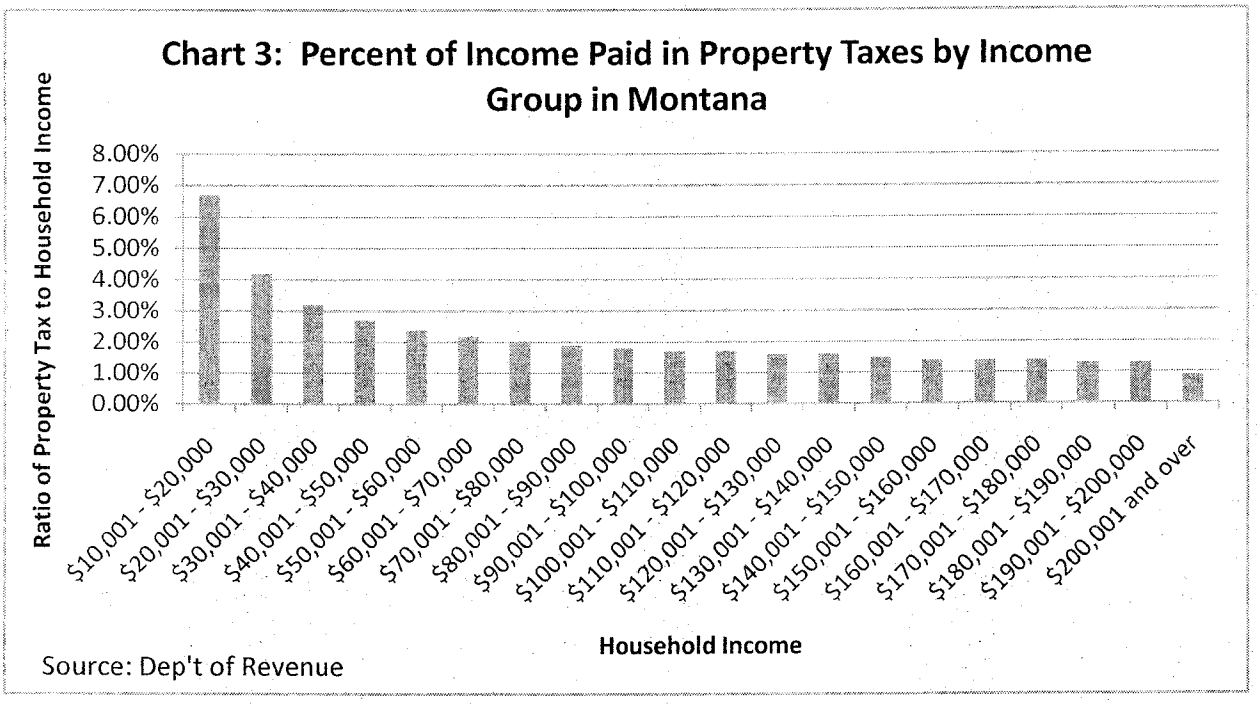
Chart 2: Class Revenue as a Percent of Total Property Tax Revenue



Source: Department of Revenue

Montana's Property Tax System is Regressive

Like most property tax systems, Montana's property tax is regressive, meaning that higher-income households pay a smaller share of their income in property taxes than lower-income or middle-income households. Property taxes tend to be regressive because they do not take into account a homeowner's income, or ability to pay, and housing costs tend to be larger in proportion to the income of low-income households than to high-income households. For example, a family making $50,000 a year may own a home costing $150,000, or three times their income, while a family making $1 million per year may own a home costing $500,000, or one-half of their income. Therefore, the property taxes paid by the low-income household will represent a greater proportion of their family income than the property taxes paid by the high-income household.



In addition, a portion of the property taxes paid on rental properties is paid by renters because the taxes are "passed through" by the landlords when setting the rent amount. The passed through property taxes paid by renters tend to represent a higher share of their income than for wealthy taxpayers. Finally, state and local property taxes can be included as an itemized deduction on federal and state tax returns, and taxpayers with higher incomes tend to use itemized deductions more often than taxpayers with lower incomes.[3] For these wealthier households, a share of their property taxes paid is recouped in the form of reduced federal and state taxes. (*Note:* Chart 3 does *not* take into account the effect of property taxes passed through to renters or the reduced effective rate paid by higher-income households as result of the federal itemized deduction for property taxes.)

[3] *See* Montana Department of Revenue, 2008 Biennial Report, p. 49 (In 2007, 26% of households in the lowest income decile itemized their deductions, while 97% of households in the top income decile itemized their deductions.)

Traditional Mitigation Methods Fail to Target the Taxpayers Who Need it Most.

Property tax mitigation has typically consisted of: (1) phasing in the reappraised values, (2) decreasing the tax rates, and (3) increasing exemptions. (See Appendix A for more detail.) This traditional method is complicated and hence difficult for constituents to understand and evaluate. In addition, the mitigation fails to adequately target those most in need of property tax mitigation, namely homeowners for whom increased property taxes would be unduly high in relation to their income.

Property tax obligations can be burdensome in relation to taxpayers' income for several reasons:

- Homeowners and renters who have relatively steady incomes may see a rapid increase in property values in their communities, resulting in higher property taxes which then take up a greater share of their incomes;
- Low-income homeowners and renters tend to have higher housing costs in proportion to their income than more affluent homeowners; because the value of these taxpayers' property is higher in relation to their income, so too is their property tax obligation; and
- Homeowners and renters may occasionally experience a sudden decline in income, for example, because of a sickness or loss of job; as the total household income declines, the property tax obligation takes up a greater share of that income.

The across the board rate cuts and exemption increases apply equally to a wealthy out-of-state vacation property owner and an elderly long-term homeowner. By applying the mitigation to high-income homeowners who have the ability to pay increased taxes based on the increased value of their assets, Montana loses revenue that it could use to either further protect homeowners with limited income or to invest in our other common priorities during a time of economic downturn and revenue uncertainty.

Other Classes of Property Already Take Into Account the Taxpayers' Ability to Pay

The fundamental problem with residential property taxes in Montana is that the market valuation of a home does not necessarily bear any relationship to a household's ability to pay property taxes. This problem is addressed to varying degrees in the other property classes by the methods used to value property in those classes. For example, agricultural land (Class 3) and forestland (Class 10) are valued based on the productivity of the land, and production value is almost always much less then true market value. In addition, commercial property (Class 4 Commercial) uses an income method to determine the value of property. In fact, the increased reliance of the income method of valuation lowered the growth in commercial property as a result of the reappraisal from a 51% average increase to a 34% increase.

In other words, for property owners other than homeowners, the legislature has made policy decisions regarding the valuation of the property which encompass an ability to pay concept. These valuations tend to be much lower than true market value because they exclude from or discount consideration of the market demand for other uses of those properties. For example, a long-time homeowner in Flathead County will see her market value and property taxes increase as a result of higher demand for land and houses in her community. In comparison, an owner of agricultural or forestland in the same community will not see "market value" (i.e. production value) or property taxes increase as a result of the same market forces.

What is a Circuit Breaker?

Circuit breakers are programs enacted by states and localities to protect homeowners who, without the programs, would suffer from unduly burdensome property taxes in relation to their income.[4] A circuit breaker is an efficient and effective mechanism for targeting property tax mitigation towards those homeowners most unable to keep up with rising property taxes. Circuit breakers typically share the following two characteristics:

- The state determines a maximum proportion of income that a homeowner is expected to pay in property taxes. This ratio varies from state to state.[5]
- Any property tax payment that exceeds this ratio for a homeowner is rebated in part or whole to the taxpayer.

> *"Property tax circuit breakers, like the electrical devices that shut off electric power to prevent circuits from overloading, prevent property taxes from 'overloading' a family's budget by 'shutting off' property taxes once they exceed a certain share of the family's income."*
>
> Center on Budget and Policy Priorities ("The Property Tax Circuit Breaker: An Introduction and Survey of Current Programs," March 2007).

In general, circuit breakers are designed to assist homeowners who pay a high share of their income in property taxes whether because of high housing costs in relation to income, steady incomes and rising home values, or declining incomes and steady home values.

[4] Karen Lyons, Sarah Farkas, and Nicholas Johnson, "The Property Tax Circuit Breaker: An Introduction and Survey of Current Programs." Center on Budget and Policy Priorities, March 2007.

[5] The Montana Elderly Homeowner/Renter Credit is not a pure circuit breaker because it doesn't set a maximum proportion of income that a taxpayer should pay in property taxes but the amount of the credit is tied to the households' income.

Appendix A
List of Property Classes in Montana

Property Class	Description	Percent Share of Total Property Tax Rev.
1	Net proceeds of mines and mining claims except coal and metal	.01%
2	Gross proceeds of metal mines	1.2%
3	Agricultural land Non-productive patented mining claims Non-qualified agricultural land	6.42%
4	Residential, commercial, industrial lands and improvements, incl. improvements on agricultural lands One acre homesteads on agricultural, forest, and non-qualified land Mobile/manufactured homes Golf courses	64.89%
5	Air and water pollution control equipment Independent and rural electric telephone cooperatives Real and personal property of "new industries" Machinery and equipment used in electrolytic reduction facilities Real and personal property of research and development firms Real and personal property used in the production of gasohol	1.5%
7	Non-centrally assessed utilities	.01%
8	Business equipment (a business with less than $20,000 in equipment is exempt)	6.92%
9	All property of pipelines and the non-electric generating property of electric utilities	11.94%
10	Forestland	.3%
12	All property of railroads and airlines	2.01%
13	All property of telecommunication utilities and the electric generating property of electric utilities	4.81%
14	Renewable energy production & transmission property	.01%
15	Carbon dioxide/qualifying liquid pipeline	
16	High voltage DC converter property	

Appendix B

Background on Property Taxes in Montana

All property is appraised, or valued, centrally in Montana by the Department of Revenue. The Department of Revenue is required by law to re-appraise the property every six years to ensure that the values reflect current market conditions. The Department is in the final stages of completing the most current reappraisal effort to be applied to 2009 property taxes.

Montana has 14 different "classes" of property (See Appendix A for a complete list of property classes.). State and local property taxes collected in Montana make up approximately 13% of our total state and local revenue.[6]

How Does the Property Tax System Work for Class 4 Residential Property?

The periodic appraisals by the Department of Revenue determine the **market value** for each piece of taxable property in the state. Unless mitigation occurs, a **tax rate**, set by the legislature for each class of property, is applied to the market value to determine the **taxable value** of the property. State and local **mill levies** are then applied to the taxable value of the property to determine the amount of property taxes owed. A mill levy is a tax rate per thousand dollars of taxable value of property. For example, the 6 mill levy that helps pay the cost of our university operations is applied to the taxable value of property at a rate of 6/1000, .006, or.6%. In total, the state imposes five different mill levies totaling 101 mills.[7] In addition to the state mills, local cities and counties apply mill levies to the property within their jurisdiction to help fund local government functions, from schools to police and fire protection. In 2008, an average of 538 mills was applied to all classes of property in the state.

Example: Determining State Property Taxes on a Residence

The statutory tax rate for residential property in 2008 was 3.01%. Therefore, assuming there are no exemptions on the property, in 2008 a home with a market value of $100,000 would have a taxable value of $3,010:

market value =	$100,000
x tax rate =	x .0301
taxable value =	$3010.

The state property taxes owed on the property would be $304.01:

taxable value =	$3,010
x 101 statewide mills =	x .101
state property taxes owed =	$304.01.

[6] State & Local Government Finance Data Query System. http://www.taxpolicycenter.org/slf-dqs/pages.cfm. The Urban Institute-Brookings Institution Tax Policy Center. Data from U.S. Census Bureau, Annual Survey of State and Local Government Finances, Government Finances, Volume 4, and Census of Governments (2006). Date of Access: (17-Jan-09 07:09 PM)

[7] An additional 1.5 mill is applied to properties in the five counties with colleges of technology affiliated with the Montana University system.

Background on Property Tax Mitigation in Montana

Typically, when property is reappraised in Montana, the legislature passes laws to mitigate the effect of the higher property values on taxpayers. For example, after the last reappraisal, the 2003 Legislature passed a law that allowed for:

- the phasing in of the higher property values over a six year period for property classes 3 (agricultural land), 4 (residential and commercial), and 10 (forestland);
- reduced tax rates for classes 3 and 4 in each of the six years (from 3.46% in 2002 to 3.01% in 2008); and
- increases in the **homestead and comstead exemptions**, which exempt from taxation a certain percentage of class 4 residential and commercial property respectively, over the six year period.

The following box shows the three mitigation factors for each of the six years in the reappraisal cycle:

Year	Tax Rate	Homestead Exemption Rate	Comstead Exemption Rate
2002 (before mitigation)	3.46%	31.00%	13.00%
2003	3.40%	31.00%	13.00%
2004	3.30%	31.40%	13.30%
2005	3.22%	32.00%	13.80%
2006	3.14%	32.60%	14.20%
2007	3.07%	33.20%	14.60%
2008	3.01%	34.00%	15.00%

Example: Determining Taxable Value on a Residence with Mitigation

For example, if a house with a previous market value of $100,000 was reappraised in 2002 at $160,000, the following table shows the calculation of taxable value for each year of the six year appraisal cycle:

Year	Market Value	Phased-In Assessed Value	Exemption Rate	Assessed Value After Exemption	Tax Rate	Taxable Value
2002	$100,000	$100,000	31.00%	$69,000	3.46%	$2387.40
2003	$160,000	$110,000	31.00%	$75,900	3.40%	$2580.60
2004	$160,000	$120,000	31.40%	$82,320	3.30%	$2716.56
2005	$160,000	$130,000	32.00%	$88,400	3.22%	$2846.48
2006	$160,000	$140,000	32.60%	$94,360	3.14%	$2962.90
2007	$160,000	$150,000	33.20%	$100,200	3.07%	$3076.14
2008	$160,000	$160,000	34.00%	$105,600	3.01%	$3178.56

Without mitigation, the taxable value of the property for years 2003 through 2008, with fully phased-in market value of $160,000, a constant exemption rate of 31%, and a constant tax rate of 3.46% would have been $3,819.84.